

Friday, July 12, 1974

Dear Member:

The public is suffering from a bad case of "economic shakes." The news is dreadful: plunging stocks, a despairing bond market, the prime rate at 12%, hints of bank troubles, recession talk. Even the Admin. is finally concerned enough to focus on economics.

This week the President met with his top economic advisers, saw leading businessmen and renowned economists outside of gov't. Clearly, the meetings were meant to shore up sagging confidence, give the impression that the Administration was doing something.

But all this activity, the widespread uncertainty, even fear, beg the question of what is really happening to the U.S. economy. RIA analysts have carefully sifted all the available evidence, come up with a series of conclusions on the state of the economy.

We aren't as pessimistic as some, not as bullish as others. What follows are what we believe to be the most crucial questions, our best judgments as to how they will be resolved -- eventually.

Q. When will prices stop rising, inflation be really curbed?

A. For prices as a whole, improvement should be clear by '75. There will be ups & downs for individual products, services, etc. but the rise in the general price level will decelerate slowly.

Reason is that today's inflation is different from any other, more deep-rooted, goes back to Vietnam deficits during boom times. Call it demand-pull, cost-push, living beyond our means, catch-up, we've run out of words to describe it. But the net result remains: Traditional remedies like tight money need time to take hold.

Q. What about a recession, can it change the price picture?

A. A recession could slow inflation, maybe stop it cold. But U.S. postwar recessions have not reversed the price trend. The best they've been able to do is slow down the upward spirals.

It would probably take a disastrous depression akin to '29, with millions jobless, to push down the price level dramatically. Obviously, gov't will opt for what we have rather than risk that.

Q. Will there be a recession soon -- this year or in '75?

A. On balance, odds are against one over the next 12 months. Most of the basic business indicators are still relatively sound. Inventories appear in little danger of becoming excessive soon. Demand, except for cars & housing, isn't falling short of supply. Inflation is the key here; could spark a recession if unchecked.

Q. Does the Admin. have a policy or is everybody floundering?

A. In a word, "NO" to both. There is no policy or strategy,

at least not in terms of specific steps, realistic alternatives, fallback positions, etc. What the Admin. calls "policy" is this: maintenance of tight, responsible, fiscal and monetary policies, while letting private industry and the marketplace go it alone.

Q. How will this "policy" or lack of it affect money costs?

A. Again, the key is inflation: Rates will go down with it. But a lessening of pressures in other fields will ease rates too, i.e. inventory accumulation, commodity speculation, foreign credit. Some of that is happening already, pointing to lower rates later.

As we've told you, we think rates are about at their peak. Question now is whether they'll ease off gently in coming weeks, or plummet precipitously once the great interest squeeze ends.

Q. When will the stock market stop sliding, start recovering?

A. Day-to-day predictions about this market seem to be futile. No one knows when the slide will stop, or how far down it'll go. But there are some given factors that must precede real recovery.

Inflation will have to slow, interest rates show some easing. The Watergate-induced pall on Washington will have to lift a bit. In fact, any resolution of impeachment, for or against the Pres., could trigger a rally in the teeth of inflation & high interest. Point is stocks can't rebound when doubt, mistrust & fear rule.

Q. What about the banks? Are they really in major trouble?

A. Flatly no. The media have overplayed scary headlines. Fact is that a small, private German bank, Herstatt, collapsed, and that the Franklin National Bank had to be rescued by the Fed. True, other banks were caught short in currency speculation too, but the system has enough resiliency to absorb such losses easily.

Q. What about economic controls, will gov't reimpose them?

A. Selective controls are possible, despite Admin. denials. Nixon has been so erratic on this one that anything could happen. Recession or slowdown, of course, would preclude any new controls. But raging inflation, high labor settlements, may bring them on.

Q. Will the Admin. hike taxes as an antidote to inflation?

A. Certainly not before the Congressional elections in Nov. What happens after that will depend on the economic situation -- though a lame duck Congress isn't likely to increase taxes in '74. Means action, if it comes, would have to wait at least till Jan.

Q. What's the best outlook for the economy in months ahead?

A. A period of sluggish growth, a kind of treadmill economy. Cost pass-throughs will have to be absorbed, money markets calmed, to allow economic pickup without any fast refueling of inflation.

Clearly, this isn't a situation to make anyone jump for joy. On the other hand, the world isn't about to come to an end either.

A Congressional drive to clear the decks of must legislation, in preparation for possible impeachment proceedings, has stalled. Despite the upcoming elections, there is little sense of urgency.

Grass-roots soundings taken on the 4th were not encouraging. "They don't really give a damn about Watergate or impeachment," a Midwestern Dem told us. "They believe Congress and the Admin. are a bunch of clowns who can't tackle bread-and-butter issues."

But lawmakers appear paralyzed, content to just drift along. Insiders believe Congress will take a month's vacation in August, come back for a month in September, go home to campaign in Oct., then return for a lame-duck session that should last till Dec.

Normally, such a long work schedule should provide the time for some action on a number of key bills of interest to business. Trouble is, no one believes this Congress has the will to move.

The impasse is caused by more than Watergate & impeachment. There's a near institutional inability to work consensus politics. The brightest legislative proposals still fall short of majority. Lack of leadership has made the nitty-gritty pragmatic bargaining, the key to winning needed opposition votes, all but impossible.

The retirement of 48, mostly seniority-laden members, hurts. What's more, turnover has been unusually high in recent sessions. Finally, prospects for a veto-proof Congress aren't that good. It adds up to a Congress with more than its usual ambivalence.

The most anyone is willing to concede will pass this session: pension reform, the consumer protection agency and trade reform.

Almost certain to be left for the next Congress to handle: federal standards for workmen's and unemployment compensation, health insurance, OSHA amendments, patent revision & land use.

The U.S.'s two biggest trade partners -- Canada and Japan -- voted this week for the tried & true, stuck to party regularity. The outcome will help set pace & direction of future negotiations, influence emerging U.S. trade patterns with both of these nations.

Though the issues were different, the results were similar: Neither electorate risked new parties, new personalities, slogans. In fact, personality was a handicap for both Trudeau and Tanaka.

In Canada, Trudeau had to shed his jet-set swinger image -- it cost him the '72 election -- and let his party run the campaign. Liberal party pros took over, produced the big Trudeau majority. Conservative leader Stanfield helped by flirting with Red Toryism. He advocated controls to halt inflation, lost worker votes fast.

In Japan, Premier Tanaka's polls were lower than Nixon's. With inflation at 25%, he is considered a totally discredited man.

Yet the nation's problems with energy, social change, pollution, were such that voters went for the security of known quantities.

For the U.S. the outcomes mean dealing with old friends -- but on a new, long-term basis that allows tackling tough issues.

Canada, for example, is "emotionally ready" to start talks, long delayed, on gas pipelines, moving oil U.S.-ward from Alberta, other questions involving exchange exploitation of resources. These include water rights, pollution, export surcharges, etc.

But Trudeau and his team won't be patsies for the Americans. Amb. Porter, veteran of Vietnam talks, will find the going tough. Ottawa wants treaty arrangements covering movement of natural gas, protection of its vulnerable industrial East against oil crises.

Trade negotiations with Japan will, if anything, be as tough. Tokyo has mounted a mammoth trade offensive to pay for its oil, and though the spearhead of the drive is aimed at Southeast Asia, sooner or later the U.S. must absorb a flood of Japanese goods. It's simply the only market large enough to count in any crunch.

Tanaka's shaved majority in the Upper House will help here. Hopefully he emerged chastened, will rely on his professionals. The bureaucracy understands the U.S., is sensitive to its needs, will be better able to rein bumptious manufacturers & exporters.

Remember "Limits to Growth," the scary rage just two yrs. ago? The thesis: Unless population, economic growth are slowed soon, the world will come to an end. The idea met with skepticism then. Now a new British book cites chapter and verse on its mistakes.

Prof. Wilfred Beckerman's "In Defense of Economic Growth" postulates plenty of raw materials, food; less people & pollution. The book argues that present world supply of metals is very high, could easily go higher if new minerals, sea riches, are tapped.

In fact, it says raw materials will last for thousands of yrs. Food depends on productivity; there'd be plenty for 60 bill. people if all agriculture were as efficient as that of Holland is today.

Besides, population growth is slowing, even in poor lands, says Beckerman, citing a study on declining fertility in 56 nations. Finally, even pollution is being harnessed in the industrial world.

Beckerman's work marks the start of what may be a new trend. A number of studies along the same lines are now in preparation. For example, an exhaustive, technical analysis directed against the zero-growth thesis is being prepared by the Hudson Institute. These new studies agree: Zero growth, No. Selective growth, Yes.

Research Institute Staff